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422085—41

# In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 674

WEST PRODUCTION COMPANY, PETITIONER

*v.*

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT*

## BRIEF FOR THE RESPONDENT IN OPPOSITION

### OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 91–108) is reported in 41 B. T. A. 1043. The opinion of the Circuit Court of Appeals (R. 143–147) is reported in 121 F. (2d) 9.

### JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 7, 1941. (R. 147–148). The petition for a writ of certiorari was filed on October 1, 1941. The jurisdiction of this Court is in-

voked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

### QUESTION PRESENTED

Whether a secured creditor who buys in the underlying property at foreclosure, realizes income in the amount of the difference between the fair market value of the property acquired and the cost of the debt.

### STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra,* pp. 11–12.

### STATEMENT

On October 27, 1931, R. S. Sterling obtained a loan of $800,000 secured by various properties pledged under a deed of trust. The loan was evidenced by notes due on or before January 1, 1934, bearing 6 percent interest. One of the properties pledged was Sterling's undivided interest in the Moss Bluff Oil Field. (R. 48–49.)

Prior to June 20, 1932, Sterling asked J. M. West, chairman of taxpayer's board of directors, to buy up the notes at a discount. Upon learning that the Humble Oil & Refining Company was interested in acquiring the Moss Bluff properties, West ascertained the price which Humble would pay for the Moss Bluff properties, and, after Sterling had agreed to the sale of the properties to Humble, negotiated for the purchase of the notes. (R. 93.)

On June 20, 1932, taxpayer purchased the Sterling notes for $320,000 and paid legal expenses of $4,039 in connection therewith. At the time of the purchase the taxpayer received cash previously paid on the notes in the amount of $118,891.98. (R. 49, 93–94.) The Moss Bluff properties were sold to Humble and on July 21, 1932, the trustee paid the taxpayer $165,000 on account of the sale of Sterling's interest in the Moss Bluff properties. (R. 49, 94.)

Sterling defaulted upon the payment of taxes and other charges on properties covered by the deed of trust and the taxpayer thereupon directed the trustee to sell the property and to apply the proceeds toward the payment of the notes. The property was sold at public sale on October 4, 1932, the personal property separately from the real property. Taxpayer bought the personalty for $1,500 and the realty for $17,300. On October 10, 1932, taxpayer received from Sterling a quitclaim deed to the realty and a bill of sale for the personalty. (R. 49–51, 94–95.) The Sterling notes were not cancelled and are still in taxpayer's possession, and no further attempt has been made to collect on them. (R. 50, 95.) The parties stipulated that the fair market value on October 4, 1932, of all the properties, real and personal, which the taxpayer acquired was $101,522.77.[1] (R. 54–56.)

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[1] This figure includes the sum of $9,534.59 received in cash by the taxpayer on October 28, 1932, as additional pro-

The Board of Tax Appeals held (R. 100–101) that the purchase by the taxpayer of the Sterling notes, the sale of a portion of the collateral, and the acquisition of the remainder were all parts of an entire transaction which taxpayer undertook and carried out during the year 1932 for profit and on which taxpayer had realized a profit. The profit was computed by the Board as follows (R. 100–101):

| | |
|---|---|
| Amount realized: | |
| Cash acquired when the notes were purchased | $118,891.98 |
| Received from Humble for interest in Moss Bluff properties | 165,000.00 |
| Fair market value of remaining collateral at date of foreclosure sale | 101,522.77 |
| | 385,414.75 |
| Cost of Sterling notes | 324,039.00 |
| Total gain realized | $61,375.75 |

The Circuit Court of Appeals affirmed the Board of Tax Appeals on this point. (R. 145–147.)

**ARGUMENT**

1. Taxpayer alleges as a ground for the granting of the writ that the question presented in this case is inseparably joined to the question pre-

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ceeds from the sale of the Moss Bluff properties to Humble. (R. 49, 56, 94.)

Taxpayer mentions (Pet. 3) that one of the properties which it acquired upon the foreclosure sale had a debt of $143,000 against it. That indebtedness was taken into consideration, and allowance made for it, in fixing the stipulated fair market value of all of the properties as $101,522.77. (See R. 55–56.)

sented in *Bondholders Committee, etc.* v. *Helvering,* and *Marlborough House, Inc.* v. *Helvering,* Nos. 128 and 129; *Helvering* v. *Southwest Consolidated Corp.,* No. 286; *Helvering* v. *Alabama Asphaltic Limestone Co.,* No. 328; and *Palm Springs Holding Co.* v. *Helvering,* No. 503. These cases are now pending in this Court on petitions for writs of certiorari which were granted October 13, 1941. The question presented in these cases is whether, when bondholders of an insolvent corporation foreclose and form a new corporation to take over the property, the new company is one formed pursuant to a "reorganization" so that it may use the basis of the assets in the hands of the old company for the purposes of computing depreciation and depletion, and gain or loss upon the subsequent disposition of the assets. In none of these cases is this Court required to decide whether, if the transactions did not constitute a reorganization, the new company must use as its basis the bid price or the fair market value on the date of acquisition. That question was involved in the companion case of *Helvering* v. *New President Corp.,* 122 F. (2d) 92 (C. C. A. 8th), in which the court determined that such transaction did not constitute a reorganization but held further that the taxpayer was entitled to use as its basis the fair market value of the property acquired as opposed to the bid price. That result is con-

sistent with the result herein. The Government does not intend to seek certiorari in the *New President* case, and since the decision in the *New President* case is in the taxpayer's favor, a petition will not be filed by the taxpayer. Therefore the pendency of the other cases raising the unrelated question whether there was a reorganization is not a ground for the granting of the writ in this case.

2. The decision below is not in conflict with *Helvering* v. *Midland Ins. Co.*, 300 U. S. 216. In the *Midland* case a life insurance company had bid in property upon which it held a mortgage at a price which included both the principal and interest due on the mortgage debt. This price was bid in order to insure that there would be no loss to the mortgagee on its investment in case of redemption by the mortgagor. The Court decided that the amount of the bid referrable to the interest on the debt constituted income to the mortgagee, but pointed out that it was dealing only with the construction of a section of the revenue act taxing life insurance companies upon "interest" received, and that such companies were taxed in a special manner. Moreover, in the instant case, both the Board of Tax Appeals and the Circuit Court of Appeals have grounded their holdings squarely upon Article 193 of Treasury Regulations 77, promulgated under the Revenue

Act of 1932. As the court below noted, an identical regulation has been promulgated under every revenue act since that of 1926.[2] Under the well settled rule this consistent administrative interpretation of the statute together with the reenactment of the statute by Congress has given the regulation the force and effect of law.[3] No comparable regulation—indeed, no regulation at all—was involved in the *Midland* case. Furthermore, Section 111 (b) of the Act specifically provides that "The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received." The regulation upon which the decision herein rests provides that where a creditor buys in the pledged property he realizes gain or loss in the amount of the difference between the fair market value of the property and the amount of the obligations of the debtor which are applied to the purchase or bid price of the property. In the absence of proof to the contrary the bid price is presumed to be the fair market value. In the instant case the fair

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[2] Treasury Regulations 69, Article 153; Treasury Regulations 74, Article 193; Treasury Regulations 77, Article 193; Treasury Regulations 86, Article 23 (k)–3; Treasury Regulations 94, Article 23 (k)–3; Treasury Regulations 101, Article 23 (k)–3; Treasury Regulations 103, Sec. 19.23 (k)–3.

[3] *United States* v. *Dakota-Montana Oil Co.*, 288 U. S. 459; *Helvering* v. *Winmill*, 305 U. S. 79, 83.

market value was stipulated by the parties and therefore there is no warrant for the use of the bid price in the computation of gain or loss. The validity of the regulation has been sustained by the Circuit Courts of Appeals for the First, Third and Eighth Circuits. *Hadley Falls Trust Co.* v. *United States,* 110 F. (2d) 887 (C. C. A. 1st); *Malden Trust Co.* v. *Commissioner,* 110 F. (2d) 751 (C. C. A. 1st); *Brown* v. *United States,* 95 F. (2d) 487 (C. C. A. 3d); *Helvering* v. *New President Corp.,* 122 F. (2d) 92 (C. C. A. 8th). All of these cases were decided after the decision in the *Midland* case and there are no contrary decisions. *Tiscornia* v. *Commissioner,* 95 F. (2d) 678 (C. C. A. 9th), is not in conflict for, as the court carefully noted, there was no evidence in the record of fair market value, and, moreover, the conclusion reached by the court is strictly in accordance with the regulation.

3. Taxpayer contends that its acquisition of the pledged property resulted in no gain or loss. But essential facts are ignored in this attempt to treat the case as one of a simple purchase of property and to apply the argument that one does not realize income by the purchase of property at a price less than its value. The acquisition of the property at the foreclosure sale in this case was not the beginning of a transaction; on the contrary it was the end of a transaction entered into for profit.

The essence of the transaction may be stated as follows: the taxpayer exchanged $18,800 (bid price at foreclosure) worth of a debt[4] which had cost $40,147.02 (price of the Sterling notes less cash realized thereon) for property concededly worth $101,522.77. This was an identifiable event marking the realization of income (or loss) and such a transaction has been so viewed in the *Brown, Hadley Falls* and *Malden Trust* cases, *supra*. The decision below is obviously correct and the taxpayer alleges no conflict with any decision of any other court on this point.

Taxpayer argues (Pet. 7) that it would be required, upon a future sale of these assets, to use the bid price as its basis for the computation of gain or loss and that it therefore could never recover the difference between the fair market value and the bid price. But this is obviously incorrect for the regulation specifically provides: "If the creditor subsequently sells the property so acquired, the basis for determining gain or loss is the fair market value of the property at the date of acquisition."

**CONCLUSION**

The case was correctly decided by the court below. The decision is not in conflict with any de-

[4] The deficiency actually determined in this case treats the balance of the debt as uncollectible, even though the taxpayer still has the Sterling notes.

cision by this Court or any other court. The petition should be denied.

Respectfully submitted.

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OCTOBER 1941.